DOES COVID-19 EXCUSE PERFORMANCE UNDER YOUR CONTRACT?

By Michael Sebree, David Jolley, and Kathrin Dimas

In light of the ongoing COVID-19 pandemic, many businesses and individuals find themselves unable or unwilling to meet their contractual obligations. In some instances, a contract may contain a *force majeure* clause that specifically identifies the circumstances under which contractual performance may be excused. Case law has held that such clauses need to be interpreted very narrowly, and their application tends to be highly fact-specific. For contracts without a *force majeure* clause, however, the parties should look to the application of state-law principles of "impossibility," "impracticability," and "frustration of purpose" to determine their contractual obligations in a time of crisis.

I. Force Majeure Provisions

A *force majeure* provision generally protects or excuses parties in the event that a part or all of the contract cannot be performed due to causes that are outside of the control of the parties and could not be prevented by the exercise of prudence, diligence, and due care. Typical *force majeure* events include acts of God, natural disasters, epidemics, terrorism, government acts, embargoes, labor strikes, and other events beyond the control of the parties. The application of a *force majeure* provision involves a highly fact-specific inquiry, with the primary focus being on whether the clause encompasses the circumstances that will result in nonperformance of the contract.

Force majeure clauses are generally interpreted narrowly. Therefore, for an event to qualify as *force majeure*, it must be specifically identified in the provision in the contract. In addition, performance must be impossible or impracticable, and the *force majeure* event must be the proximate cause of the nonperformance. Mere economic hardship, increased expense, or a resulting monetary loss does not excuse performance under a *force majeure* provision unless there exists an extreme and unreasonable difficulty, expense, or injury. [i]

In analyzing the current COVID-19 pandemic, the primary determination that needs to be made is whether the COVID-19 outbreak is a covered event. In other words, does the provision in your contract specifically include "epidemics," "quarantines," or similar circumstances as a *force majeure* event. Although most *force majeure* clauses provide exclusions for "Acts of God," some courts have limited this term to mean the unforeseen and unpreventable force of weather or natural planetary elements, such as lightning strikes, tornados, hurricanes, etc.[ii] However, even if "epidemics" is not specified, a *force majeure* clause may still encompass the current situation if it identifies "acts by government entities" as a precluding event. At the present time, California's governor has prohibited public and private gatherings and has ordered non essential workers to shelter-in-place in their homes. Accordingly, performance under many non-essential contracts would likely be illegal (and therefore impossible) under the current circumstances.

Most *force majeure* provisions additionally require prior notice, often in writing, before a

party will be excused from performance. It is critical that such notice provisions are followed carefully, as failure to do so may result in a waiver of nonperformance rights.

II. State Law Principles that May Excuse Performance

In the absence of a *force majeure* provision in your contract, California law may nonetheless provide an excuse to contractual performance under certain circumstances.

A. Impossibility or Impracticability

California recognizes both "impossibility" and "impracticability" as a defense to performance. Specifically, any condition in a contract "which is impossible or unlawful" to be fulfilled is void pursuant to Section 1441 of the California Civil Code. In addition, Section 1511(2) of the California Civil Code provides that contractual performance is excused "[w]hen it is prevented or delayed by an irresistible, superhuman cause, or by the act of public enemies of this state or of the United States." Further, California courts have recognized as a defense not only objective impossibility in the true sense, but also impracticability due to excessive and unreasonable difficulty or expense.[iii] While the doctrine of impracticability involves a lesser showing to justify nonperformance than impossibility, it does not excuse contractual obligations simply because performance became more expensive than anticipated or would result in a loss. Rather, it excuses performance when the difference in cost is so great as to make performance manifestly unreasonable (although technically possible). [iv]

In instances in which impossibility or impracticability is temporary, the obligation to perform is usually only suspended during the time the conditions exist.[v] However, temporary impossibility/impracticability of indefinite duration will sometimes be sufficiently permanent to justify a complete termination of the contract.[vi]

The current COVID-19 epidemic may provide a defense for some California businesses looking to avoid contractual obligations if such performance would be impossible or impracticable at present. Under California law, performance is excused where prevented "by the operation of law."[vii] Thus, if performance would necessarily contravene California's current shelter-in-place order, it is likely excused (at least temporarily). In addition, if performance is impossible or impracticable because of excessive and unreasonable difficulty or expense resulting from the epidemic (as opposed to mere unforeseen difficulty or expense), such performance may be excused. [viii]

B. Frustration of Purpose

A modern excuse for performance recognized in California is "frustration of purpose" or "commercial frustration". Aspects of this doctrine are codified in California in Section 2615 of the California Commercial Code and in Section 1932 of the California Civil Code.

Frustration of purpose may be established where the parties, at the time of contracting, assume a certain purpose of the contract will be achieved, but this purpose is later rendered impossible as a result of a not reasonably foreseeable supervening event.[ix] In other words, performance is technically possible, but there is no longer any value to at least one party in moving forward.[x] In order to excuse nonperformance of a contract on the ground of frustration of purpose, the frustration must be so severe or substantial that it is not fair to be regarded as within the risks that were assumed under the contract.[xi] It is not enough, however, that the transaction will become less profitable for the affected party or even that it will sustain a loss.[xii]

For example, a large industry group reserves a gathering space for over 1,000 people and hundreds of hotel rooms for its annual convention in California. After signing the contract with the hotel, the COVID-19 epidemic breaks out and the governor issues an executive order prohibiting any public or private gatherings in the state. Although the hotel could still provide the convention space and the rooms, the purpose for doing so, the convention gathering itself, has been frustrated (i.e., made unlawful). The industry group may

be excused from performance under these circumstances.

Even though this scenario seems like a textbook example of the doctrine of frustration of purpose, it should be noted that courts have shown a lot of hesitation towards discharging parties from their contractual obligations based on the general policy that parties should be held to their contractual promises. The frustration of purpose doctrine should, therefore, be viewed as a narrow equitable doctrine reserved for situations of extreme hardship.

III. Conclusion

Force majeure provisions and the doctrines of impossibility, impracticability, and frustration of purpose, like most contractual clauses and legal doctrines, are subject to interpretation and may be interpreted differently depending on the facts and circumstances present. Donahue is here to assist you in assessing your various contractual rights, including the applicability and enforceability of these clauses and the availability of these defenses as you continue your risk avoidance and mitigation efforts related to COVID-19.

---

[1] Butler v. Nepple, 54 Cal.2d 589, 599(1960) (fact that compliance with the contract would involve greater expense than anticipated did not excuse performance)
[1i] London Guarantee & Accident Co. v. Industrial Accident Commission of California ,202 Cal. 239, 242 (1927)
[1ii] Christin v. Superior Court, 9 Cal.2d 526, 533 (1937)
[1v] Mineral Park Land Co. v. Howard, 172 Cal. 289, 293 (1916)
[v] See Rest.2d, Contracts §§ 269-70
[vi] Autry v. Republic Prods., 30 Cal.2d 144, 148, 155 (1947)
[vii] Civ. Code § 1511(1); see National Pavements Corp. of Cal. v. Hutchinson Co., 132 Cal. App. 235, 238 (1933)
[viii] See Mineral Park Land Co., 172 Cal. at 293 (where unforeseen flooding caused expense of project to be over ten times as great as originally contemplated, this extraordinary increase rendered performance impracticable)
[ix] Federal Leasing Consultants, Inc. v. Mitchell Lipsett Co., 85 Cal.App.3d Supp.44, 47 (1978)
[x] Rest.2d, Contracts § 265; La Cumbre Golf & Country Club v. Santa Barbara Hotel Co., 205 Cal. 422 (1928)
[xi] FPI Dev., Inc. v. Nakashima, 231 Cal. App. 3d 367, 399 (1991)
[xii] Id.

Michael Sebree
Partner
msebree@donahue.com

David Jolley
Partner
djolley@donahue.com

Kathrin Dimas
Partner
kdimas@donahue.com

DONAHUE FITZGERALD ATTORNEYS